Assignment of Claims
Administrative Expenses
11 U.S.C. § 507(a)(3)

In re Agripac, Inc. 699-60001-fra7

10/6/00 Alley Unpublished

PF Acquisition, II and Chiquita Processed Foods (collectively "Claimants") purchased the frozen foods and canned foods divisions, respectively, of the Debtor. Because the Debtor's Collective Bargaining Agreements ("CBO's) with its employees had not been rejected under 11 USC § 1113, the Claimants had to either assume the CBO's with the purchase or reach an understanding with the labor unions. The Claimants entered into new agreements with the unions to the effect that the terms of the original CBA's would be followed, but that the Claimants would not assume the Debtor's liabilities under the original agreements.

The Claimants approached their new employees with an offer that they would honor the accrued vacation rights of the employees in exchange for an assignment of their claims against the employees' former employer, the Debtor. Claimants then filed administrative expense claims with the Estate for the claims so assigned on the theory that any claim under a CBO not rejected under § 1113 and payable post-petition is entitled to administrative priority. The Trustee objected and all parties filed motions for summary judgment.

The court held that vacation pay related to time worked by employees within 90 days prior to the petition date is entitled to priority under § 507(a)(3) up to $4,300 per employee. Vacation pay related to time worked by employees from the petition date to the date the Claimants took over as employers is entitled to administrative expense priority. Remaining vacation pay claims are non-priority.

UNITED STATES BANKRUPTCY COURT

DISTRICT OF OREGON

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| IN RE | ) | |
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| AGRIPAC, INC., | ) | Case No. 699-60001-fra7 |
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| Debtor. | ) | MEMORANDUM OPINION |

PF Acquisition II, Inc. ("PFA") and Chiquita Processed Foods, LLC ("Chiquita") (collectively referred to here as "Claimants") have filed proofs of claim seeking payment, as an administrative expense, of vacation pay accrued by the Debtor's employees prior to Claimants' acquisition of Debtor's canning and packing facilities. The Trustee has objected to the assertion of priority. Each now seeks summary judgment on the liability and priority issues raised by the claims.

The parties have stipulated that the court may determine the "legal issue," that is, the vitality and priority of the claims, by ruling on the cross-motions for summary judgment. The right to contest particular claims (e.g., whether a particular employee accrued the time claimed) is reserved.

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I find that the Claimants are holders of the vacation pay claims of Debtor's former employees, and that the claims are entitled to third priority under 11 U.S.C. § 507(a)(3) for vacation pay accrued within 90 days prior to the petition date, and first (Administrative) priority under § 507(a)(1) for pay accruing between the date of Debtor's petition for relief and the date the employee's workplace was transferred to the Claimants. The balance of the claims are non-priority. My reasons follow.

## I. FACTS

While the parties differ on many details, the essentials of the controversy are not disputed: Debtor Agripac, Inc. was an agricultural cooperative, maintaining facilities for canning and frozen packaging of various commodities. It filed a petition for relief under Chapter 11 of the Bankruptcy Code on January 4, 1999. At the time it was operating frozen foods and canning divisions. Its employees' pay and vacation rights were governed by collective bargaining agreements ("CBAs") with three different unions, and an employee handbook detailing the rights of non-union employees. In addition, there were separate employment agreements with several executive-level employees.

On February 29, 1999, the Court authorized the sale of the frozen foods operations to claimant PFA. On April 29, 1999 a similar order was entered authorizing the sale of the canning plants to Chiquita. The case was converted to Chapter 7 soon thereafter.

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Notice of each sale was given to creditors and other interested parties. In each case an objection was raised by one or more unions representing Agripac's workers. In the sale of the frozen foods division to PFA, the court was advised, without detail, that the objection had been addressed, and that the union consented to the sale.

Originally, the canning plant was to be sold to Norpac. In light of the unions' objections, the court ruled that the sale could go forward only after Agripac complied with Code § 1113[1], or an agreement made with the unions which rendered such compliance moot. Norpac was unable to reach an agreement with the unions and, for that reason among others, terminated its agreement to purchase. Chiquita stepped in, and was authorized to purchase the facilities in Norpac's place. Chiquita and the unions were able to reach an agreement satisfying the court's requirements. (The agreements between the Claimants and the unions are described in more detail below.) In each case the Claimant agreed to honor vacation pay claims of employees, in return for an assignment by each employee of his or her claims in bankruptcy based on accrued vacation rights.[2] Claimants now

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[1] Code § 1113 provides that a collective bargaining agreement may not be rejected by a debtor-in-possession unless the DIP first proposes an alternative, and bargains in good faith with the Union.

[2] One aspect of the transition is the subject of some dispute. Claimants assert that all of Agripac's employees were terminated, and immediately rehired by PFA and Chiquita. The Claimants, in turn, agreed to enter into Collective Bargaining Agreements (CBA's) identical to those between Agripac and the

assert these claims in the employees' stead. The Trustee objects.

## II. ISSUES

The issues presented by the cross-motions are:

1. The origin and nature of the claims;

2. The priority of the claims under Code § 507; and

3. Whether the priority scheme under § 507 is modified by operation of § 1113.

## III. DISCUSSION

### A. Summary Judgment

Disputed claims are contested case matters, and subject to summary judgment under Fed R. Bankr. P. 7056. Fed. R. Bankr. P. 9014. Summary judgment is appropriate when the pleadings, depositions, answers to interrogatories, admissions, and affidavits, if any, show that there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56, made applicable by Fed. R. Bankr. P. 7056. The movant has the burden of establishing that there is no genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). The primary inquiry is

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employees. The Trustee believes that the employees were never terminated by Agripac. The only context in which this difference seems to matter is the employee handbook, which provides that no payment will be made for accrued but unused vacation unless the employee has been terminated. However, I believe that the sale of the plants and cessation of operations by Agripac must be considered a termination of the employee for purposes of wage-related claims. It follows that it is immaterial whether the employees were formally terminated.

whether the evidence presents a sufficient disagreement to require a trial, or whether it is so one-sided that one party must prevail as a matter of law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247 (1986).

The Court may enter a partial summary judgment, and issue an order specifying the material facts not subject to dispute: such facts are deemed determined upon trial of remaining issues. Fed R. Bankr. P. 65, Fed R. Civ. P. 56(d). Summary judgment may be limited to liability issues, with claims or damages left for further proceedings. Fed R. Bankr. P. 7056, Fed R. Civ. P. 56(c).

B. Origin and Nature of Claims

Some time after the Claimants acquired the Debtor's two processing operations they approached their employees with substantially the same offer: that the new employer would honor an employee's right to paid vacation accrued while working for Agripac, in return for an assignment of the employee's claim in this bankruptcy case on account of such right.[3] For the sake of

[3] The assignment form presented by Chiquita to former Agripac employees provides:

> The undersigned employee of Chiquita Processed Foods, L.L.C. ("CPF"), hereby sells, transfers, and assigns to CPF (and to its successors and assigns) all right, title, and interest in and to the undersigned's claims against Agripac, Inc., an Oregon cooperative corporation ("Agripac") and against Agripac's bankruptcy estate, for vacation pay and sick leave pay and benefits earned or accrued though April 29, 1999 [the date Chiquita acquired the plant from the debtor-in-possession] (whether or not

this discussion, I assume that all eligible employees availed themselves of the opportunity. To the extent this is not correct, the stipulation allows for further proceedings to adjust the claims. In any event, the scope of my ruling is limited to the claims assigned by employees to the Claimants.

The claims under consideration here arise out of provisions in Agripac's Employee Handbook (covering non-union employees) and Collective Bargaining Agreements providing for paid vacations. Under each agreement, an employee is granted the right to take a specified amount of time off from work with no interruption in his or her regular paychecks. The amount of time off is governed by the length of employment. The right to vacation accrues over the length of the preceding year, to be honored over the course

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> entitled to priority in Agripac's bankruptcy case under 11 USC Section 507).
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> If the undersigned has filed a proof of claim in Agripac's bankruptcy case with respect to the claims hereby assigned, the undersigned waives any notice or hearing requirements imposed by Federal Rule of Bankruptcy Procedure 3001(e) and stipulates that an order may be entered in Agripac's bankruptcy case substituting CPF for the undersigned as the owner and holder of the claims hereby assigned for all purposes. The undersigned agrees that if any payment or other distribution on account of the claims hereby assigned is hereafter received by the undersigned the undersigned will, immediately upon receipt, deliver the same to CPF in the form received, duly endorsed as appropriate.

Substantially the same form was provided by PFA to its Agripac employees.

of the following year. For example, a member of Teamster Local 670 employed for between 3 and 7 years is entitled, at the end of the year, to two weeks paid vacation over the course of the ensuing year.

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The validity of the assignments is not in doubt. It may be argued that the Claimants were compelled by the unions to honor the vacation pay claims accrued under Agripac, in return for the unions' acquiescence in the transfer, or that the Claimants simply assumed Agripac's obligation. The Claimants, for their part, insist that they entered into new employment CBA's, and assumed none of Agripac's employment related obligations. They characterize their decisions to honor the vacation pay claims as simply in keeping with their established personnel policies. Whatever the Claimants' motivation, it is clear that they have taken the assignments in return for consideration, and are now the holders of the employees' several claims.

The Trustee argues that the Claimants are not assignees of the employees, but subrogees. This distinction is important, since the holder of a claim by virtue of subrogation cannot claim the priority under § 507 held by the original Claimant. Code § 507(d). The Trustee, relying on *In re Mid-American Travel*, 145 B.R. 969, 972 (Bankr. E.D. Ark. 1992), argues that the assignments, taken after Claimants had taken over the businesses – and after they had made peace with the unions – did not alter the Claimants' status as subrogees subject to § 507(d).

Claimants take the position that the fact that they may be seen as subrogees is immaterial; they still hold the claims by assignment, and, as assignees, entitled to claim the priority attendant to each claim. *See, e.g., In re Florida*, 164 B.R. 636, 640 (BAP 9th Cir. 1994).

This much is clear from the record now before me:

1. The collective bargaining agreements were not rejected in the manner required by Code § 1113. In fact, there is no evidence that Agripac ever attempted to comply.

2. As a condition of acquiring the plants, Claimants were required either to assume the CBA's, ensure that any rejection of the CBA's was in accordance with § 1113, or make some other arrangement with the unions rendering compliance with § 1113 moot.

3. The Claimants did not simply assume the CBAs. Instead, they entered into agreements with the unions to the effect that the terms of the original CBAs would be followed, but that the Claimants would not assume Agripac's liabilities under the original agreements.

The Trustee characterizes the Claimants as subrogees because they undertook to honor Agripac's obligations to its employees in order to protect their own interests, even though they were not actually bound to pay the claims. *Hult v. Ebinger*, 222 Or. 169, 352 P.2d. 583 (1960). In order to purchase the plants, the Claimants were required either to: (1) ensure that Agripac

satisfied § 1113 by assuming outright the CBA's[4] , or (2) reach some other agreement with the unions allowing them to purchase

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without assumption, thus rendering moot Agripac's failure to comply with § 1113. They chose the second course.

The "Memorandum of Agreement" ("MOA") between PFA and Local 670 reads as follows:

> PF Acquisition II, Inc. ("PFA") hereby assumes the Collective Bargaining Agreement between Teamsters Local 670 and Agripac, Inc., and as the successor employer will abide by its terms as they apply only to the Frozen Food Division operation purchased from Agripac, as approved by the Bankruptcy Court in Case No. 699-0001-fra11.
>
> *Notwithstanding the foregoing, PFA's monetary obligations under the Collective Bargaining Agreement will begin to accrue effective as of the closing of the asset purchase transaction* contemplated by the Asset Purchase Agreement between PFA and Agripac, Inc. dated February [left blank], 1999, but only with respect to PFA's employees who are covered by the terms of the Collective Bargaining Agreement. *In no event shall PFA, or any affiliate of PFA, have any liability directly or indirectly, for dues, contributions, or the like that accrued or became payable by reason of the business operations of Agripac, Inc.* The undersigned parties hereby agree that this paragraph shall not be construed or act to modify or diminish in any way the accrued seniority and seniority rights of the employees under the Collective Bargaining Agreement.

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[4] The CBAs had a provision requiring that any sale of Agripac's business be conditioned on assumption by the buyer of the CBA. The court held that the provision was enforceable as long as the CBA was in effect, and that the CBA remained in effect since Agripac had not complied with § 1113.

> This Memorandum of Agreement shall be appended to and shall be considered part of the Collective Bargaining Agreement. [Emphasis added]

Substantially similar memoranda were agreed to between PFA and its other unions, and between Chiquita and Local 670.

These memoranda do not implement simple assumptions by Claimants. Instead, Claimants and the unions agreed to what amounts to a new CBA, adopting the terms of the old one, but relieving Claimants of any liability with respect to member's prior employment by Agripac. Subsequently and (perhaps) separately, the Claimants made deals with the employees whereby Claimants honored Agripac-related vacation pay – obligations excluded by the MOAs – in return for assignment by the employees of their claims in the bankruptcy. Claimants' documents suggest, and their memorandum intimates, that they shouldered the vacation pay burden as a matter of company policy, and to enhance employee morale. Cynics might think that they did so only because the unions insisted as part of the deal. Or both may be true. It does not matter. The Court approved the sales on the condition that the CBAs be assumed or that the unions consent to some other arrangement. The agreement arrived at was obviously designed to allow Claimants to recoup some of its cost of acquisition from the estate. This is not, by itself, unlawful, or even unreasonable. Had the acquisition not taken place, the employee claims would still be with us. (Indeed, they may have been greater, had Agripac stayed in business longer). Likewise,

any purchaser taking a straight assumption at the insistence of the unions, court, or creditors, may have insisted on a lower price to offset the cost of assumption.

*Mid-America Travel Services, supra.* Is inapposite. There the creditor, a credit card issuer, was required to reverse – that is, pay back – charges made by customers to the debtor travel agency when the agency failed. The Court held that the creditor was, by virtue of the payments, subrogated to the claims of the customers. The creditor sought priority treatment for such claims to the extent they were for deposits by consumers. Code § 507(a)(6). The priority claim was denied under § 507(d).[5]

The distinction lies in the fact that the creditor in *Mid-American Travel* was obligated to pay the customers under its pre-existing agreement with them. Here, the Claimants' had no pre-existing duties to the employees. They undertook their obligations to the employees either as part of a new labor contract with the Unions, or for independent reasons, and in return for the assignments. Either way, the Claimants hold the employees' vacation pay claims by assignment, and not subrogation, and are entitled to the same treatment of the claims as were the employees themselves.

C. Priority of Claims

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[5]Section 507(d): An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection (a)(3), (a)(4), (a)(5), (a)(6), (a)(7), (a)(8), or (a)(9) of this section is not subrogated to the right of the holder of such claim to priority under such subsection.

There are, effectively, two claims for each employee: one for vacation accrued prior to the January 4, 1999 petition date, and one for vacation rights accruing between the petition date and the date the Claimant took over as the particular employee's employer.

*Post-petition claims*

Claims for vacation accruing to an employee working for Agripac as an operating debtor-in-possession are actual and necessary costs and expenses of preserving the estate, and are payable by the estate as administrative expenses under Code § 503(b). *See In re St. Louis Globe-Democrat, Inc.* 86 B.R. 606 (Bankr. E.D. Missouri 1988). Such expenses are accorded first priority under § 507(a)(1).[6]

*Pre-petition claims*: *Effect of § 1113*

Claimants argue that they are entitled to administrative priority treatment for all of the claims assigned to them by union members, on the theory that any claim under a collective bargaining agreement not rejected under § 1113 is entitled to administrative priority. I do not agree.

As noted, administrative priority is given to claims allowed under § 503(b), which allows claims for expenditures for "the actual, necessary costs and expenses of preserving the estate,

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[6] Administrative priority for these claims is based on the fact that the employees provided the service and became entitled to payment post-petition, and is not dependant on the existence of a collective bargaining agreement or the operation of § 1113. See below.

including wages, salaries, or commissions for services rendered *after the commencement of the case*" [Emphasis added], § 503(b)(1), and for other expenditures not relevant here. This plain language precludes administrative priority for services rendered before the case was commenced. *See, e.g., In re Russell Cave Co.*, 248 B.R. 301 (Bankr. E.D. Ky. 2000); *In re Palau Corp.*, 18 F.3d 746, 750-751 (9th Cir. 1994).

Claimants assert that all the vacation pay claims are entitled to administrative expense priority on the theory that the claims are *payable* post-petition, and because § 1113 operates to prevent rejection of the CBAs.

The priority of a wage claim is controlled not by when it accrues, or is payable, but by whether the services which gave rise to the claim were for the preservation of the estate. § 507(a)(1). The court must determine whether the beneficiary of the services is the pre-petition debtor, or the post-petition debtor-in-possession (and hence the estate). Here the employees working pre-petition accumulated vacation rights as compensation for their pre-petition services to the Debtor. These services were of no benefit to the estate, and for that reason are not subject to administrative priority. The fact that the payment of a debt is due post-petition does not, by itself, make the debt an administrative expense.

Code § 1113 governs the manner in which collective bargaining agreements may be rejected, but does not alter the priority of claims based on CBAs, either rejected or assumed.

The enforcement of collective bargaining agreements, which is the subject of § 1113, and the priority of claims arising under CBAs, governed by § 507, are separate issues. *In re Ionosphere Clubs, Inc. (Ionosphere II)*, 22 F.3d 403,407 (2d Cir. 1994). In *Ionosphere*, the Court of Appeals considered union claims for vacation pay owed to its members by Eastern Airlines. The unions reasoned that failure to compel payment of the claims as an administrative expense effectively modified the CBA, in derogation of § 1113. The Court replied that

> Application of the priority scheme in section 507 will not allow Eastern unilaterally to modify or terminate its obligations under the CBA. In holding as we do, we are not drawing a mere semantical distinction. Eastern's obligation to satisfy in full the vacation pay claims remains unchanged. Section 507 only establishes the priority of those claims, it does not affect the underlying obligation. As the District Court recognized, 'Judicial ordering of benefit claims pursuant to § 507 is not equivalent to employer avoidance of obligations under a collective bargaining agreement. The collective bargaining agreement is respected, but the financial obligations issuing from it are accorded priority consistent with the Bankruptcy Code.'

*Id.*, citing *In re Ionosphere Clubs, Inc.*, 154 B.R. 623, 630 (S.D.N.Y. 1993).

The purpose of § 1113 is to ensure that standards of fair dealing and good faith bargaining between unions and debtor-employers are preserved. However, there is nothing in the language of the section to suggest that Congress intended the section to alter the priority provision of § 507. Had Congress so intended, it could have done so by making explicit provisions to that effect, such as those found in § 1114, regarding benefits

of retired employees.

Claimants cite to *In re Arrow Transp. Co. of Delaware, Inc.*, 224 B.R. 457 (Bankr. D. Or. 1998). In *Arrow* the debtor-in-possession made, post-petition, payments to employees on account of vacation pay accrued pre-petition. More precisely, the DIP, "as a matter of industrial relations," decided to allow employees who, pre-petition, had scheduled vacations, to take them post-petition with pay. 224 B.R. at 460. The Court, following *In re Ionosphere (Ionosphere I)*, 922 F.2d 984 (2d Cir. 1990), held that a CBA remains in effect until and unless rejected after compliance with § 1113, and that the DIP had not complied. The Court went on to find that, since § 1113 operated to keep the CBA in place, payments under the CBA were "authorized" for purposes of § 549, which allows for avoidance of "unauthorized" post-petition transfers. The opinion deals with the viability of the vacation pay claims, in the context of § 549, but not their priority. Nothing in the decision supports Claimants' position regarding administrative priority for the vacation pay claims.

*Pre-petition claims: § 507(a)(3)*

Since claims accruing before the petition is filed cannot be said to be for the "actual and necessary costs and expenses of preserving the estate," it follows that pre-petition claims cannot be granted administrative priority. Claims for wages, including vacation pay, accruing in the 90 days prior to a bankruptcy are accorded priority by § 507(a)(3), to the extent of $4,300. *In re Ionosphere Clubs, Inc. (Ionosphere II)*, 22 F.3d

403, 407 (2d Cir. 1994). It is well established that this priority extends to vacation-related claims accrued in the 90 days before the bankruptcy petition. *Id.* at 409. In this case, Claimant is entitled to third place priority (after § 503(b) and § 502(f) claims) to the extent it has undertaken to pay for vacations accrued between October 6, 1998 and January 4, 1999. For those employed for the entire year, this means an amount equal to 24.7% (90/365) of the total vacation pay. For those hired after the first of the year, the percentage increases accordingly: for example, the claim of an employee hired July 2 is for 49.5% (90/182).

## V. CONCLUSION

The court finds as follows:

1. The vacation pay claims are allowable.

2. Vacation pay claims based on services rendered in the 90 days preceding the bankruptcy are allowed third priority under § 507(a)(3).

3. Vacation pay claims based on services rendered after the petition for relief and before the date the Claimant took over as the particular employee's employer are entitled to administrative priority under § 507(a)(1).

4. Remaining vacation pay claims are non-priority.

With regard to salaried employees who earned vacation pay on a monthly basis to be used the following year, § 507(a)(3) priority shall be given to those vacation days actually credited to the employee which were attributable to days worked in the 90

days preceding the petition date. Likewise, vacation days credited to employees post-petition shall be given § 507(a)(1) priority to the extent they relate to days worked after the petition date and before the date the Claimant took over as the new employer.

The Trustee has argued that the Claimants are estopped to claim priority treatment for vacation pay under § 1113, or have waived such claims. I do not understand the Trustee to claim that such claims are not entitled to priority under § 507(a)(3). In light of the foregoing, (in particular, the Court's rejection of Claimants' assertions under § 1113) it is not necessary to address the estoppel and waiver issues.

The foregoing memorandum constitutes the Court's findings of fact and conclusion of law. Counsel for the Trustee shall submit an order consistent with this memorandum.

FRANK R. ALLEY, III
Bankruptcy Judge